

## **Emsley Tromp: How can we shape a better future for the Curaçao tourism industry?**

Keynote speech by Dr Emsley Tromp, President of the Central Bank of Curaçao and Sint Maarten, at the annual general meeting, organised by the Curaçao Hospitality and Tourism Association, Willemstad, 25 March 2015.

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Ladies and gentlemen, good afternoon,

It was with great pleasure that I accepted the invitation to share with you my views on the importance of the tourism industry for the economy of Curaçao and how we can maximize its growth potential. I firmly believe that for small open economies like ours, tourism, which is a thriving industry, provides a solid foundation for growth. Suffice it to note that while Curacao's economic growth has averaged a disappointing 0.6% over the past 10 years, stay-over tourism in Curaçao has increased by an average of 8.1%. Today it is the country's most important industry in terms of real value added, foreign exchange earnings, and employment. The question now becomes, can we shape a better future for our tourism industry and make it the driver for economic growth? Or put differently: do we still have room for more growth in the tourism sector?

Ladies and gentlemen, I am convinced that we do. However, we need to keep in mind that success in this industry depends, among other things, on our ability to remain an attractive destination. In addition, this industry is very susceptible to changes in the external environment. Conditions can change in the blink of an eye. Consequently, we need to continuously enhance our ability to adjust to this changing environment. At the same time, to achieve a higher growth path we need to address some important issues in our economy.

The world has changed drastically in recent decades, becoming more globalized with capital, goods, knowledge, and especially people moving faster than ever. As the global economy expands and people become wealthier, they will be spending a larger share of their income on leisure activities, such as travelling. In 1950, for example, 25 million tourists travelled around the world; in 2014, the number exceeded 1.1 billion. This record number in 2014 represented 4.7% growth compared to 2013, and 2014 was the fifth consecutive year of higher than average growth since the global financial crisis. Tourism has become a major driver of socioeconomic progress for developed, emerging, and developing economies as it generates foreign exchange income, creates jobs and business opportunities for enterprises, and encourages the development of infrastructure.

In 2014, tourism generated approximately US\$ 1.4 trillion in global foreign exchange income, approximately 30% of the export of services. According to the World Travel and Tourism Council, tourism contributed 9% of global GDP and global employment. Tourism has risen significantly in recent years and the World Trade Organization (WTO) expects this trend to continue, reaching 1.8 billion tourists by the end of 2030.

As one of the world's fastest growing industries, tourism has brought about more diversification and competition among destinations. Also, due to innovation and continuous technological developments, tourists have become more hands-on, sophisticated, and demanding. This shift in tourist behavior has led to new tourist destinations in addition to the more traditional destinations of Europe, North America, and the Caribbean.

Tourism is also one of the most resilient global industries. Through the years, it has proven capable of handling setbacks and adapting to the changing environment in which it has to operate. Moreover, tourism helps preserve and stimulate countries' natural and cultural heritage. Today, investments in tourism even take into account environmental aspects, particularly the prevention of environmental degradation.

Ladies and gentlemen, moving now to our region, the Caribbean is commonly referred to as the world's most tourism-dependent region. Tourism constitutes the region's most important economic pillar, contributing 14% of Caribbean GDP and 11% of its total employment. Also, the sector generates the largest share of foreign exchange income. In spite of its small scale and vulnerability to external shocks, our region has registered continued growth in the number of tourist arrivals. In 2014, for example, 26.3 million tourists traveled to the region, representing a 5.3% growth compared to 2013.

Similar to most Caribbean economies, tourism is the most important pillar of the Curaçao economy. This sector directly contributes 9.2% of GDP and 9.6% of employment. Moreover, 26.5% of foreign exchange earnings from the export of goods and services are generated by the tourism industry. The industry also has indirect spin-off effects across all sectors of the economy, particularly the hotels & restaurants, wholesale & retail trade and transportation sectors. Furthermore, the tourism sector contributes to the economy in terms of investments and government income. In this context, the tourism industry is highly labor intensive and, therefore, creates opportunities for many small and medium enterprises that provide goods and services to this industry.

Since 2011, the sector has been experiencing continued growth, driven by both stay-over and cruise tourism. For instance, in 2014, 1.1 million tourists – both stay-over visitors and cruise passengers – visited Curaçao, representing a 3.2% growth compared to 2013. This positive development in the tourism industry over the past four years is attributable to, among other things, an increase in our room capacity with the construction of new hotels, increased airlift, and more marketing efforts to promote Curaçao as a tourist destination. However, a comparison of our growth figures with those of other Caribbean destinations suggests we have not yet reached our potential. For example, while Curaçao recorded a mere 2.5% growth in 2014, stay-over tourism in Aruba grew by 9.5% and Sint Maarten recorded a growth of 7.1%. This begs the question of why we cannot sustain stronger growth in stay-over tourism. To answer this question and increase growth, we can draw on the experiences in the region.

If we are to sustain stronger economic growth overall, ladies and gentlemen, achieving higher growth in the tourism sector is indispensable. During the past decade, Curaçao's economic growth averaged a mere 0.6% per year. Meanwhile, unemployment, particularly youth unemployment, remains unacceptably high.

In the period preceding 10–10–10, there were good reasons to think that a period of stronger economic growth could be sustained. As part of the constitutional restructuring, Holland provided us with debt relief, lowering the burdensome debt-to-GDP ratio to a healthy 35%. The interest expenses of the public sector declined to NAf. 50 million from the towering figure of NAf. 350 million. Government could now issue bonds under the same modalities as the Dutch government, thereby implicitly achieving a AAA rating for its bonds. Meanwhile, our foreign exchange reserves reached historic highs of nearly NAf. 2,7 billion. The constitutional restructuring also meant that the wasteful duplication of the double layer of government was eliminated leading to a more manageable public sector and thus public finance. These developments led to much optimism and hence a favorable investment climate sufficient to withstand the impact of the Great Recession. Curacao was among the very few countries that managed to record growth in the aftermath of the developments of 2008. However, as the old adage goes, not all that can be counted counts.

In the years that followed, the investment climate deteriorated quickly and the much-needed investment dried up. The political headwinds that ensued after 10–10–10 and the fiscal restraint required by the Kingdom government to bring our financial household in order masked the developments I outlined above.

The government has focused primarily on meeting the conditions stipulated in the Kingdom Financial Supervision Act. We have spent most of our energy on achieving and maintaining fiscal sustainability, while neglecting strategies to stimulate economic growth. Even though

lengthy discussions have been ongoing about strengthening the economic pillars of Curaçao, including ship repair and international financial services, and developing new economic sectors, it is again only the tourism sector that has made significant progress.

As I have mentioned on earlier occasions, people often believe that stimulating economic growth and the development and strengthening of specific economic pillars is the responsibility of the government alone. However, developments in our tourism and financial sectors have driven home the point that private sector-led initiatives are crucial to achieve the desired development and growth of an industry. Meanwhile, the role of the public sector is to create the right investment climate and regulatory framework for businesses to operate, grow, and invest. This collaborative approach is the best recipe for creating sustainable economic growth and progress.

In the case of our tourism sector, thanks to these joint efforts, Curaçao has been able to benefit from increased airlift, which for many years was considered one of the main obstacles to further growth. Increased airlift, however, must go hand in hand with increased hotel accommodations. Otherwise, we will face the problem of having tourists willing to come to the island, airlift to bring them, but no place to accommodate them.

Curaçao needs to be able to offer a high standard of hotels and luxury villas to cater to the high-end market. Right now, some existing hotels need upgrading, and numerous projects have been announced in recent years but construction activities have yet to start.

Ladies and gentlemen, if we want to achieve a higher growth path for tourism, we need to invest more in the industry. Today's investment is tomorrow's growth. Investments are needed to upgrade and expand our hotel capacity and other accommodations. However, a major impediment remains vis-a-vis the availability of risk capital to finance large investment projects in this industry. Shortage of risk capital is a major obstacle for tourism development in many countries, and Curaçao is no exception. The main reason for the shortage of risk capital is that hotel and other major investment projects in the tourism sector are typically riskier and more complex than other investment projects and, hence, require specially designed terms of financing.

Investment projects in the tourism sector, such as the construction of hotels, have relatively high fixed costs and high operating expenses. In addition, hotel projects present a number of risks associated with the project itself, the players involved in the project, and the project's financial structure. Hotel projects also must take into account adverse external risks, such as economic and political stability and exposure to natural disasters.

For these reasons, commercial banks and institutional investors are reluctant to provide the necessary financing to the tourism industry. Consequently, private investors who cannot meet the requirement of sufficient equity demanded by the financial institutions will not be able to realize their projects and promising investment projects remain forever in the pipeline. This situation has typically created certain challenges in our region and even had unintended consequences for the industry. Nevertheless, this growth path should be pursued.

Ladies and gentlemen, you will not be surprised to learn that I do not share these concerns. On the contrary, I am of the firm view that the time for muddling through is over. Blindly super-imposing on us solutions that might have worked elsewhere, is done at the expense of more problems in the future. To this point, I refer to the much-debated Aqualectra and the Sint Maarten Harbour bonds that were bought by the Bank.

As I mentioned, as part of the constitutional restructuring of the Netherlands Antilles, the Netherlands provided debt relief to the constituent parties of the former Netherlands Antilles. By taking over the entire outstanding public debt of both the Central government and the government of the island territory of Curacao, the market of government securities dried up overnight. Even with this Nafl 4 billion market of government bonds, institutional investors thought there were insufficient investment instruments available in the country. In addition, with the disappearance of that market, the Central Bank was also deprived of an important

instrument in its arsenal for Open Market Operations, thereby constraining the effectiveness of monetary policy. To provide impetus and further develop this market, the Central Bank embarked on an asset purchase program to build its portfolio of corporate bonds. Although views of those operations differed, the ultimate goal was to create a new instrument for the conduct of monetary policy in line with our mandate – namely, to promote the stability of the guilder.

The purchases of these bonds resulted in lower yields, which by no means were limited to the individual bonds that were purchased. These lower yields have given rise to spillovers that also compress the yield of bonds with a similar maturity. In addition, they also reduce the overall duration risk borne by the market and lower the interest rate risk borne by investors, accordingly affecting the entire term structure. The compression of interest rates creates incentives for investors to rebalance their portfolio away from riskless securities.

Ladies and gentlemen, unconventional times call for unconventional measures. However, these little understood asset purchases, aside from their positive impact on the development of the corporate bond market and the lowering of electricity and water prices, have been mired in unintended consequences, which have constrained their use to address our financing needs in the tourism industry.

Various governments in the region have traditionally sought alternative ways to address this shortage of risk capital and, hence, unlock private investments in the tourism sector. These alternatives include the provision of guarantees and public-private partnerships. For example, in the case of Aruba, the provision of government guarantees resulted in an investment boom in the tourism sector in the late 1980s and early 1990s. From 1986 to 1992, the number of hotel rooms there rose from 2,776 to 7,103, a growth of more than 150 percent. However, as we have witnessed, this experience is not without its risks to fiscal sustainability.

Alternatively, governments could stimulate cooperation between the public and private sectors to share investment costs, risks, responsibilities, and profits generated from tourism projects. The degree of funding and risk allocation to the public and private sectors depends on the asset procurement model chosen. This cooperative approach requires a high degree of collaboration and, therefore, generates efficiency, cost effectiveness, synergies in terms of knowledge, skills, and expertise, pooling of capital resources, innovation and diversity, and effective utilization of public assets. On the other hand, the approach is complex, time-consuming, and entails some difficulties with regard to the implementation of the projects.

Government policies in the last few years have been dictated by the CFT-mandated fiscal consolidation. While this consolidation is a necessary condition for macroeconomic stability, the disproportionate emphasis on fiscal restraint at the expense of other areas of government, has held back growth in recent years and given way to the view that this operation may have pushed us into a longer-lasting valley of economic misfortune. The economic jury is still out on whether this period of sub-par growth is temporary or not.

If we are to reverse this trend, ladies and gentlemen – and there are good reasons to think that we can – and sustain a period of stronger growth, tourism is the key! If we take, for example, the much anticipated Hard Rock Hotel, the construction phase of this project will lead to an additional 0.2% real GDP growth a year, assuming a construction period of 2.5 years. Moreover, during the construction phase, 180 additional jobs will be created. Once operational, the additional room capacity created by the Hard Rock Hotel will host more than 26,000 stay-over visitors per year. As a result, the hotel will contribute approximately 1.7% to GDP and an additional inflow of foreign exchange revenues of NAf.62 million a year. The hotel also will generate 300 direct and 150 indirect jobs. However, to realize this project, a shortfall of risk capital in the order of NAf.172.0 million must be bridged.

Ladies and gentlemen, the government has raised over NAfl 500 million to finance its capital expenditures during the last two years. If we are to compare the economic impact of these borrowings with the potential impact of the abovementioned hotel project, we have to

conclude that the balance is unequivocally in the direction of the hotel project. While the government borrowing may be necessary on social grounds, it has not created a single permanent job nor will it add to long-term sustainable economic activities. A fraction of this amount invested in hotel projects would produce an abundantly bigger sustained impact on our level of economic activities.

Given the key insights we have drawn from the past, we have reason to be cautious. In particular, any government assistance must be designed so it does not endanger our hard-won fiscal stability. Therefore, I argue against any direct government assistance in terms of participation in private sector investments.

Investments in tourist projects in the recent past have been possible thanks to the mezzanine financing structure offered through the *Social Economic Fund*. Mezzanine financing is a hybrid form of financing between debt and equity that gives the lender the right to convert its debt title in ownership through an equity interest in the company if the conditions warrant it. Mezzanine financing offers a solution when business opportunities are increasing but investors lack sufficient equity capital and, hence, are unable to obtain the required debt financing. However, mezzanine financing is not supposed to be a permanent feature of the firm's capital structure.

Mezzanine financing offers the borrower flexibility in shaping amortization schedules, including specifying special conditions for repayment, and other borrowing conditions. Another advantage is that the borrower obtains financing while increasing his debt leverage, thereby increasing his chances to obtain additional debt financing. From the provider's perspective, mezzanine financing offers a higher interest rate compared to senior debt, such as bank loans, and it is more liquid than private equity investments.

To meet the current needs in the tourism industry, the government could address the lack of risk capital in various ways. The government of Curaçao is in the process of creating a new development bank that should provide more risk capital for investments. In anticipation of that new bank's creation, the government could encourage the OBNA to play that role and make risk capital available now. Alternatively, the government could make mezzanine financing fiscally attractive.

Ladies and gentlemen, in addition to addressing the financial bottlenecks, attention should also be directed at other areas that can negatively impact the growth and development of the tourism industry. One of these areas is the qualitative mismatch between labor supply and demand. The tourism industry is an important employer; therefore, it is vital to equip our youth with the necessary skill set to meet the requirements of this industry. If our youth lack these skills, they will continue to have trouble finding jobs in this growing industry.

Ladies and gentlemen, as I mentioned, competition between tourist destinations has become more intense. Consequently, tourist destinations need to address those areas where they lag behind vis-à-vis their competitors. In this context, the rigidities in our labor market, our high cost of doing business, and the complex administrative procedures and red tape in our government apparatus need to be addressed. Numerous studies and reports have presented recommendations on how to address these weaknesses of our investment climate. If we are to achieve this higher growth path, we do not have time to muddle through.

In conclusion, we should not be content with our relatively low tourism growth rates compared to the double-digit growth rates in other Caribbean countries. We need more private investments to expand and continually improve our tourism product to meet the tourists' changing needs. To increase private investments, we need to facilitate financing for large investment projects. Moreover, achieving higher tourism growth is a joint effort, in which collaboration between the public and private sector is indispensable. As a Dutch saying goes: "Doing everything on your own is adding up. Collaboration is multiplying."

However, the joint effort is not limited to collaboration between the private and public sectors. Each member of our community plays a part in the experience of tourists in our country.

Therefore, it is important to change our mindset and become more service-oriented and customer driven.

Let me finish by saying that we need to be more ambitious and aim for excellence. A wise man once said: *“The biggest risk is not taking any risk... In a world that is changing quickly, the only strategy that is guaranteed to fail is not taking risks.”*

Ladies and gentlemen, I thank you for your attention and wish you a fruitful meeting.